

**TESTIMONY OF IRWIN TRAUSS, ESQUIRE**

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**HEARING ON FORECLOSURE MITIGATION**

**BEFORE THE  
TROUBLED ASSET RELIEF PROGRAM (TARP)  
CONGRESSIONAL OVERSIGHT PANEL**

**SEPTEMBER 24, 2009**

Madam Chairperson and members of the Oversight Panel, thank you for the invitation to appear this morning to describe the role of Philadelphia Legal Assistance and the Save Your Home Philly Hotline in the Philadelphia Court of Common Pleas Mortgage Foreclosure Diversion Pilot Program (“Diversion Program”); to discuss with you the challenges we face in working with lenders to obtain affordable loan modifications and other resolutions that will enable our clients to avoid the loss of their homes; and to describe the effect Making Home Affordable (“MHA”) has had on our ability to achieve affordable and sustainable arrangements that will keep folks in their homes.

My name is Irwin Trauss. I am an attorney. I supervise the Consumer Housing Unit of Philadelphia Legal Assistance (PLA), an LSC- funded program in Philadelphia, Pennsylvania. I have had this position at PLA for the past 13 years. For the previous 20 years I worked for Community Legal Services (CLS) in Philadelphia in a similar capacity. For almost thirty-three years I have primarily represented low-income homeowners faced with the loss of their homes through mortgage foreclosure, litigating as necessary in state, federal and bankruptcy court. In addition, I have overall responsibility for the operation of the Save Your Home Philly Hotline which, over the past almost 17 months, as part of the Philadelphia Court of Common Pleas Mortgage Foreclosure Diversion Pilot Program (Diversion Program), has handled about 11,000 calls from Philadelphia homeowners facing the loss of their homes to foreclosure.<sup>1</sup> Since April

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<sup>1</sup> Since May of 2008, the Hotline has received an average of between 600 and 700 calls a month. Paralegals who work under the supervision of attorneys whom I supervise take the calls. The paralegals on the Hotline triage the calls. They explain the diversion program; make appointments for the callers with housing counselors; and provide information and advice to homeowners, housing counselors and others involved in helping homeowners save their homes. In appropriate cases they refer the homeowners to the legal services attorneys at PLA or Community Legal Services (CLS) for representation. In a small number of cases they make referrals to private attorneys. The Hotline staff also monitors the operation of the Diversion

of 2008 every person faced with the imminent loss of his or her home through foreclosure has been referred by the Court to the Hotline. As a result, we have an intimate sense of what is happening with foreclosures in Philadelphia.

I understand I have been invited to testify today to provide the perspective of someone who, day in and day out, represents homeowners attempting to stay in their homes. From that perspective, it appears to me that voluntary modifications resulting from programs such as the Diversion Program and MHA will not enable families to save their homes in the vast numbers required to significantly stem the tide of foreclosures. Voluntary modifications, while helpful to some people, in my experience, only help at the margins. Preventing foreclosures in the numbers necessary to have a significant impact on the continued erosion of the housing market and the mass dislocation of people from their homes requires something more. We are faced now with loans that are defaulting for a combination of reasons. In addition to the millions of loans that are in default because they were unaffordable and unsustainable when they were made, we now have millions of defaults that are the result of the rising tide of unemployment. To address this situation we need a multi-pronged approach that is not dependent on the willingness of the mortgage servicers to agree to the solution and is not dependent on the lenders determining for themselves whether they have complied with the requirements of the program.

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Program and provides feedback to the Court on behalf of homeowners for whom the Diversion Program has not worked as intended. I and attorneys I supervise, as well as attorneys from CLS with whom we work closely, help train the volunteer attorneys and the housing counselors. At least one attorney from my unit is present in court every day on which conciliation conferences are scheduled to take place to mentor pro bono attorneys and as a resource for the housing counselors. Finally, I and the attorneys and substantive paralegals in my unit undertake extended representation, which can include litigation, in about 200 new cases a year.

MHA as presently structured was designed primarily to address foreclosures resulting from loans that were unaffordable because of their design. It was not designed to address the second wave of foreclosures we are now experiencing, which is caused by the massive spike in unemployment. TARP money being recovered from the banks needs to be re-purposed to a MHA program that is specifically designed to meet the needs of the unemployed.

For example, people whose incomes have been interrupted or substantially reduced by unemployment, but who have fair loans at fixed interest rates, could benefit greatly from a federal loan program using TARP funds that is loosely modeled on the Pennsylvania Housing Finance Agency's (PHFA) Homeowner Emergency Assistance Program (HEMAP). HEMAP provides loans to cure mortgage defaults and continuing assistance to keep mortgage payments current until temporary reductions in income caused by such things as unemployment, illness and other circumstances beyond the borrowers control are resolved. The loans bear no interest until they are in repayment status and they are not in repayment status until the homeowner's income is restored and until the homeowner can afford to make repayments. Since 1983 when the HEMAP program was created in Pennsylvania, it has collected more in loan repayments than it has paid out to assist homeowners under the program. A homeowner who can afford her current monthly mortgage payment, because he or she is back to work, but who has arrears from a period of unemployment, can get no help from the present MHA. Such a person would be able to keep her home with the help of an additional MHA program that contained HEMAP-like features.

Most importantly, substantive changes in the law, such as the proposed amendments to the Bankruptcy Code, which have been passed by the House, but defeated in the Senate, that require loans to be modified to make them affordable, are also needed as a means of giving

homeowners meaningful leverage in their dealings with servicers. Unless homeowners have leverage to force favorable results, lenders will continue to avoid the meaningful modifications that are necessary to keep folks in their homes.

While Making Home Affordable has made a significant difference in a small percentage of the cases that we have seen in Philadelphia, it has not resulted in a significantly greater willingness on the part of servicers to enter into modifications that meaningfully reduce monthly payments. It has not resulted in a willingness of lenders to reduce the principal due or even to reduce the amount of principal subject to interest. Servicers look for reasons to avoid making the modifications when they are most needed, rather than for opportunities to make them.

I say this based on my personal experience, and based on the information I glean in my role as the supervisor of the Hotline, as a mentor to the housing counselors and to volunteer attorneys who represent clients in the Diversion Program and as an active member of the mortgage foreclosure steering committee who has been involved from the beginning in the creation and operation of the Diversion Program.

The Save Your Home Philly Hotline is run by Philadelphia Legal Assistance with funding primarily from the Philadelphia Office of Housing and Community Development. The Hotline is an instrumental part of the Philadelphia Court of Common Pleas Mortgage Foreclosure Diversion Pilot Program - a program designed to reduce the number of homes lost to foreclosure by requiring lenders to meet with homeowners to explore alternatives before a judgment in foreclosure can be entered and before a sheriff sale of a home can take place.

Pennsylvania is a judicial foreclosure state. Under the Diversion Program, in each foreclosure case filed with the Philadelphia Court of Common Pleas, a conciliation date is scheduled. The court provides notice to the homeowner of the date along with a notice to

contact the Hotline. As part of the program the homeowners are referred by the Hotline staff to housing counselors who help them put together affordable proposals and supporting documentation that will enable them to stay in their homes. The proposals are submitted to the mortgage servicer and to the attorney representing the servicer, who are supposed to respond with a counter-proposal. If there is a gap between the proposal and the counter-proposal, the homeowner can appear on the date set for the conciliation conference and take advantage of available volunteer “judges pro tem” appointed by the Court to assist the parties in reaching an affordable sustainable agreement by bridging the gap between the respective proposals. Under the program, the housing counselor is expected to accompany the homeowner to the conciliation conference and pro bono attorneys are supposed to be available to represent the homeowners at the conferences.

The Diversion Program provides an important procedural break that pauses the foreclosure process. It also provides a forum in which lenders and their attorneys can be and are encouraged to look for alternatives to foreclosure - alternatives that the lenders and their attorneys might otherwise overlook in the rush to foreclosure. The Diversion Program increases the possibility that the homeowner will be able to find an advocate, in some cases a housing counselor, in some cases an attorney, and in some cases both, who will help the homeowner take advantage of programs that are available to prevent foreclosure, including state programs such as HEMAP, the PHFA sponsored HERO and REAL loan program, the federal Hope for Homeowners loans (H4H) or programs that the lenders are obligated to explore such as the FHA loss mitigation programs, FHA HAMP, and HAMP. The Diversion Program also increases the chances that the homeowner will be able to obtain an attorney to defend the foreclosure and to challenge unlawful loan provisions and unlawful charges.

Most importantly, the Diversion Program involves the lenders' attorneys in the search for alternatives. Largely as the result of the herculean efforts of Judge Rizzo, who oversees the program, and the participation of the lenders' bar in its creation, the Diversion Program fosters an environment in which there is an expectation that lenders' counsel will play a role in urging their clients to consider alternatives to foreclosure. As a result of the Diversion process, lenders have offered borrowers affordable loan modifications that would not otherwise have been available to them.

Many homeowners in Philadelphia have greatly benefitted from the existence of the Diversion Program. During its almost 18 months of operation, the Diversion Program has enabled probably several hundred homeowners, who without the program would have lost their homes to foreclosure, to enter into agreements that will enable them to keep their homes, for the time being at least. Including those who have reached agreements that have for now put an end to the foreclosure actions, there are over 1600 homeowners whose foreclosures have been put on hold and who have either reached a resolution or are working on one. This is out of approximately 10,000 homeowners who were eligible for the program and about 5,000 who participated.

The precise figures are not easily discerned, because we have not yet devised a way to examine the agreements that are reached to determine their affordability and sustainability and the people who enter into agreements through the program are not being followed in any systematic way. One cannot easily determine what is happening from the court records themselves, because settlements are not always reflected on the dockets and the dismissal of a case on the docket does not prevent the filing of a new foreclosure action. It is in fact not

unusual for lenders to abandon one foreclosure action and to institute another, particularly if there is a change in servicer.

At bottom, though, the Mortgage Foreclosure Diversion process is voluntary and in it a resolution cannot be imposed upon an unwilling mortgage servicer. It is has been my experience that absent external pressure, i.e. absent some leverage that can be applied by the homeowners or on the homeowners' behalf, lenders have not ordinarily been willing to significantly compromise the mortgages to make them affordable over the long run, even in the Diversion Program. They usually do so when they are forced to, either by an aggressive advocate, by the prospect of litigation, by litigation that frustrates their attempts to foreclose or by pressure applied directly or indirectly, often discreetly, by the Court or the judges pro tem through the Diversion Program, where the homeowner is able to get before Judge Rizzo or before an active judge pro tem.

We are now more than six months into the implementation of MHA. We have found that MHA has made it easier to obtain delays in mortgage foreclosures cases in the Diversion process that have been helpful to homeowners, while the lender considers the homeowner's HAMP application. And we have found that the existence of HAMP and FHA HAMP has provided persistent and dedicated advocates with additional tools with which to leverage agreements from reluctant lenders. But, the existence of MHA and HAMP has not meaningfully affected the overall dynamic. With or without MHA, homeowners represented by knowledgeable advocates who are backed up by counsel prepared to litigate get resolutions that are simply not available to a homeowner who is not so represented. For the most part, HAMP has not been self-effectuating and the number of actual HAMP modifications, as opposed to trial agreements, has been small. I am aware of, fewer than 10 completed HAMP modifications



amongst the clients of all the housing counselors and legal services attorneys who are involved in the Diversion Program.

Both before and after MHA, in the Diversion Program when servicers, either through their attorneys or directly, make loan modification or forbearance proposals, it is not unusual for the proposal to contain provisions that may deprive the homeowner of rights they are entitled to under applicable law and that increase the overall obligation, at the same time the proposal might lower the monthly payment. For example, I have repeatedly seen servicers offer modifications of FHA loans with interest rates that are in excess of the maximum rate permitted by FHA for a loan modification. And I have seen new loan balances that include fees and costs in excess of the amount permitted by the mortgage documents and by the FHA regulations.

The arrival of MHA has not significantly affected the way the mortgage servicers and their counsel operate. It is but one more program with which servicers and their attorneys generally have to be forced to comply - and with which they will refuse to comply if it suits their purposes.

With HAMP it is sometimes difficult to discern if the noncompliance is intentional or is the result of a lack of training, or a combination of the two. But the non-compliance with the HAMP guidelines is pervasive and the absence of a meaningful method to challenge this non-compliance is frustrating to advocates - particularly to housing counselors who were led to believe that HAMP would be streamlined and self effectuating without the need for an attorney or for litigation.<sup>2</sup>

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<sup>2</sup> The Housing and Economic Recovery Act of 2008 provided \$30,000,000 to be used to pay for attorneys to assist homeowners in foreclosure who have legal issues that cannot be handled by housing counselors. Ironically, despite legislative history to the contrary, the Neighborhood Reinvestment Corporation, charged with administering the funds, has interpreted

For example, though the Servicer Participation Agreement (SPA) Bank of America (BoA) signed with FNMA required it to participate in the Home Affordable Modification Program (HAMP), callers to the Hotline reported that Bank of America refused to send them HAMP applications when their loans were not owned by FNMA or FHLMC. Hotline paralegals, calling on behalf of clients, were told repeatedly by BoA loss mitigation employees that only GSE-owned loans are eligible for HAMP. This continued until sometime in August of 2009. Bank of America was openly violating the terms of the contract it signed with FNMA. During that time, BoA foreclosed on homeowners entitled to the benefits of HAMP as if the program did not exist, denying thousands or perhaps tens of thousands of homeowners the opportunity to save their homes.

Mortgage servicers such as Saxon Mortgage, after an initial moratorium on the foreclosure sale of homes brought about by its signing the SPA, simply rejects homeowners for consideration under HAMP, apparently for no reason that is in any way connected with the program requirements, with no notice of any kind to the homeowner. Within the last three months I had a case in which Saxon's attorney advised me that my client would not be considered under HAMP because she "did not meet the debt to income ratios of the program." My request for further explanation, of which "ratios" the attorney was referring to, went unanswered.<sup>3</sup> Of course there are no "debt to income" ratios required for eligibility under the

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the Act to preclude its use to pay for attorneys providing representation to homeowners in the Diversion Program. The money is intended to be used to provide legal assistance to help homeowners avoid the loss of their homes through mortgage foreclosure. Yet under the implementing regulations, the money cannot be used once an action in mortgage foreclosure has been filed - precisely when the services of an attorney become essential.

<sup>3</sup>Despite our participation in the Diversion Program and despite the existence of HAMP we were forced to file a bankruptcy to prevent the client's home from going to foreclosure.

HAMP program other than the requirement that the mortgage payment, including principal, interest, taxes and insurance, exceed thirty one percent of the homeowner's gross income. At the same time we were told that the client did not meet the debt to income ratios for HAMP, we were also told the client could not afford the mortgage. Saxon's lawyer made no attempt to reconcile these two positions, which are irreconcilable under the HAMP guidelines. It is not unusual for homeowners participating in the Diversion Program to get no notice that the servicer has concluded that a HAMP modification is unavailable, other than to learn that the house is back on the sheriff sale list, which is what happened in my case, or that a judgment has been entered.

This is not an isolated incident. Housing counselors and attorneys representing homeowners are often told by counsel for the lender that a particular homeowner will not be considered for HAMP because his or her income is insufficient, after an initial postponement is granted so that a HAMP application can be considered. A case brought to my attention at the beginning of this week is representative of the approach servicers seem to take to evaluating HAMP eligibility. The case is of a client who is participating in the Diversion Program. The homeowner was referred to a housing counselor, who requested a HAMP loan modification. The lender's attorney agreed to extend the time in which a default judgment could be taken so that the HAMP application could be considered. No new conciliation conference date was scheduled. The extension for filing a response passed and the lender's attorney entered a default judgment against the homeowners. After taking the default judgment the lender's attorney provided the following explanation for why the homeowner would not be considered for HAMP or any other loan modification :

“... our client advised the borrower was unable to qualify for HMP. the client stated there were no options, in that borrower cannot afford anything, as the income is only \$1000/mo which is only enough to cover the utilities and food.”

When pressed for further clarification of the HAMP denial, the attorney responded in a subsequent email to the housing counselor as follows:

“My client has clarified why there are unfortunately no loan modification options available. The borrower's income is unfortunately too low. Specifically, the borrower only gets \$231 per week of unemployment income, which is \$1001 per month. The 31% "affordable" payment needs to include PITI (P&I plus taxes and insurance). 31% of \$1001.00= \$310.31, minus the escrow of \$114.27= a P&I of \$196.04, which cannot be met by either reducing the interest rate or by adding a balloon. Further, the unemployment ends in May so there is no guarantee for income after that. Thank you.”

This response reflects a wholesale misunderstanding of the eligibility for HAMP and of the steps the servicer is supposed to take in processing a HAMP application and applying the HAMP “waterfall.” Reference to an amortization table reveals that at 2% over forty years, a payment of \$196.04 supports a principal loan balance of \$64,736.92. This principal balance is not even \$3, 00.00 less than the \$68,000.00 original principal amount of the high interest rate mortgage the homeowner took out in November of 2006. The application of the HAMP waterfall would require approximately \$19,000 of the \$83,672.18 judgment<sup>4</sup> that was entered in the case to be set aside as a non-interest-bearing balloon payment. The lender’s apparent belief that application of the HAMP waterfall cannot result in a loan modification that will allow the homeowner to pay \$196.06 a month in P+I, is clearly without foundation. And the fact that the homeowner may have no income when the unemployment ends after more than nine months is

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<sup>4</sup> The default judgment that was entered in this case was inflated by foreclosure fees and costs that are of questionable validity, but which the borrower cannot now contest since a default judgment was entered while the homeowner and her counselor awaited the lender’s response to the HAMP application.

irrelevant to eligibility for HAMP. Perhaps the lender is saying that the modification required by the application of the HAMP “waterfall” would fail the NPV test, but there is no way to discern this from the reasons given for the denial.

We are finding that, in violation of the HAMP guidelines, servicers are routinely and intentionally “grossing up” income, such as social security income, disability payments and unemployment compensation payments, even though the gross amount of the income is already being reported to the servicer. This overstated gross is then being used as the basis for denying the homeowner consideration for HAMP under the 31% of income test. Where the homeowner remains eligible for HAMP despite the servicer’s exaggerated income calculation, they are required to make trial monthly payments that are often unaffordable and in excess of 31% of the true income. In such a circumstance the homeowner’s failure to pay the excessive trial payment is then used as a basis for denying the homeowner a permanent HAMP modification.

The whimsical nature of the servicers’ decisions to refuse to engage in HAMP modifications is brought home by a case handled by an attorney whom I supervise early in the summer, which involved Wells Fargo. The homeowner’s request to be considered under HAMP was denied because, according to Wells Fargo’s attorney, “[h]er debt to income ratio for the mortgage alone is over 70%. Her monthly mortgage payment cannot be lowered to bring it within HAMP guidelines and still payoff the mortgage debt.” There was no suggestion that the NPV test was implicated or that the NPV test was even done.

The reason given for the denial was nonsensical in light of the HAMP requirement that anyone with a mortgage payment exceeding 31% of gross income is eligible for consideration for a reduction of the mortgage payment to 31% and for the subsequent application of the NPV test. Despite the absurdity of its position in the face of the HAMP guidelines, Wells Fargo only

relented from its position that HAMP was unavailable and the house would be sold when we embarrassed it into doing so by bringing its position to the attention of a representative of FNMA during a fortuitous fact-finding trip he made to Philadelphia. Wells Fargo reversed itself, decided the client is eligible for HAMP, postponed the sheriff sale and is redoing its calculations. Had the homeowner been without counsel, as most are even in the Diversion Program, her home would have gone to foreclosure sale, despite the Diversion Program and despite MHA.

Virtually every servicer arbitrarily excludes whole classes of homeowners from consideration under HAMP.<sup>5</sup> These servicers refuse to consider modifying the loans of folks who have inherited their homes or obtained them as the result of property settlements resulting from divorce. The servicers take this position because in such a case the owner of the property is not a party to the underlying note, even if she has been paying it for years and if the original mortgagor is dead or otherwise unavailable. HAMP permits no such exclusion. There is nothing in the HAMP guidelines that permits the servicer to require the signature of a deceased person as a condition of HAMP participation and there are specific provisions regarding divorced persons that are often ignored by the servicers.

We also see servicers who seem to routinely say that the investor will not allow them to do a HAMP modification as well as some mortgage holders, in particular HSBC, whose mortgage servicers almost always find some excuse for refusing to modify a mortgage, often

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<sup>5</sup>HAMP by its express terms excludes a large class of folks who are most in need of help. It does little for a person at 200% of poverty or less whose mortgage payments may be less than 31% of her income, but are still unaffordable because the remaining 69% of income is insufficient to cover the cost of food, clothing, transportation, utilities and other minimum basic necessities of life. HAMP also is of little help to someone who is back to work after building up a large arrearage because of a disruption in income resulting from illness or unemployment, but because of the resumption in income cannot meet the 31% of income test.

saying that the pooling and servicing agreement does not permit a HAMP modification. In these cases the servicers make no apparent attempt to convince HSBC to make the modifications, as required by the HAMP guidelines. And there is no way to test whether the assertion regarding the pooling and servicing agreement is even true, as it is never produced and reference to where the prohibition lies is never provided.

In cases involving a FNMA loan, we have seen servicers deny HAMP applications to homeowners because their incomes were too small. This is a circumstance which is almost impossible, given that there is no NPV test for FNMA and FHLMC loans. If the mortgage payment is more than 31% of a homeowner's income, she should be eligible for HAMP consideration and for the application of the waterfall.

Compounding the failure of the servicers to adhere to the HAMP guidelines is the lack of transparency surrounding the HAMP denial, particularly in the application of the Net Present Value Test (NPV). I can find no requirement in the guidelines for an affirmative notice to a homeowner whose HAMP application is turned down, absent a trial repayment period. There is no requirement of notice of the reason for the turndown and no notice of the assumptions that are made by the servicer in applying the NPV test. Because of this, it is difficult, if not impossible, to challenge a lender's refusal to agree to a modification and often difficult to even discern that a negative decision has been made until it is too late to prevent the sale of a home or the entry of a default judgment. The forum in which a challenge to a denial can be mounted is not clear and it is certainly not clear that a foreclosure sale can be prevented while the challenge is brought. Servicers almost uniformly take the position that they are not precluded from moving forward with a foreclosure while they consider a request for a HAMP modification despite the guidelines to the contrary.

The Diversion Program can sometimes provide a forum in which the HAMP denial can be tested, if the homeowner has notice of the turndown before a sale takes place or a judgment is entered and if the homeowner has an advocate who is capable of getting the issue before the Court. But, because the diversion program is at bottom a voluntary program, it is not presently designed to provide for the review of a lender's refusal to provide a HAMP modification or to determine if the lender has complied with the requirements of the program. The Diversion Program does have the capacity to evolve and perhaps could evolve into a forum in which a lender's failure to abide by the requirements of HAMP could be routinely reviewed. But we are not there yet.

I have learned recently, by chance, that there is a HOPE Hotline Escalation Team that is supposed to provide "an avenue for borrowers to complain about improper denials and receive an explanation for their denial." It appears the Treasury Department has filed a document with the Court in connection with litigation in Minnesota which refers to this team. According to the Treasury Department's filing, this team has been in place since July 10, 2009, though its existence has not been publicized and we are unable to find any mention of it on the Hope Now website or on any other relevant government web site. I believe I can safely say that as of two days ago I was probably the only person in Philadelphia who had even heard of this team. We have no experience with the Escalation Team, but will see if we can find a way to contact it and if it provides an avenue for obtaining relief from improper HAMP denials.

Absent significant leverage on the part of homeowners to force a change in behavior, the majority of servicers will continue to find ways to avoid meaningful loan modifications despite HAMP and MHA as presently structured. The only way to change the servicers' behavior to the extent required to make meaningful modifications common is to provide the homeowner with



leverage over the servicer, such as the threat of a bankruptcy judge imposing a modification, and loan programs, such as the one I discussed above and grant programs that have been proposed by others designed to help the unemployed, that do not depend on the cooperation of the servicers. The availability of such options for homeowners would likely complement voluntary programs such as HAMP and the Diversion Program and substantially increase the chances that meaningful long-lasting alternatives to foreclosure will result.

Thank you again for the invitation to share my experience with you. I would be happy in the future to provide any information which might be of assistance to this Panel in monitoring the effectiveness of the programs under TARP that are designed to help folks avoid the loss of their homes.